BODY:	**CABINET**
DATE:	**4th September 2013**
SUBJECT:	**Finance Matters - Treasury Management Outturn 2012-13**
REPORT OF:	**Chief Finance Officer**

Ward(s):	All
Purpose:	To report on the activities and performance of the Treasury Management service during 2012/2013
Decision Type	Key decision
Contact:	Alan Osborne, Chief Finance Officer, Financial Services Telephone Number 01323 415149.
Recommendations:	Cabinet is recommended to: 1. Agree the annual treasury management report for 2012/13. 2. Specifically approve the 2012/13 prudential and treasury indicators included.

1.0 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2012/13. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2012/13 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 6 February 2013)
- a mid year (minimum) treasury update report (Council 12 December 2012)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee.

Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 23 March 2010 in order to support Members' scrutiny role.

1.2 This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.

2.0 The Council's Capital Expenditure and Financing 2012/13

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2011/12 Actual £m	2012/13 Estimate £m	2012/13 Actual £m
Non-HRA capital expenditure	5.07	6.80	5.14
HRA capital expenditure	9.59	7.74	7.14
Total capital expenditure	**14.66**	**14.54**	**12.28**
Resourced by:			
• Capital receipts	0	2.16	2.45
• Capital grants & Contributions	3.02	4.88	4.77
• Major Repairs Reserve	3.28	3.11	2.01
• Revenue & Reserves	0.15	0.79	0.09
Use of internal balances	**8.21**	**3.60**	**2.96**

3.0 The Council's overall borrowing need

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.4 The Council's 2012/13 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2012/13 on 8 February 2012.

The Council's CFR for the year is shown below, and represents a key prudential indicator. The figures below include a one off settlement of £30.48m received from central Government as part of the HRA refinancing in 2011-12. The figures also include a credit sales agreement on the balance sheet, which increases the Council's borrowing need, the CFR.

CFR	31 March 2012 Actual £m	31 March 2013 Original Indicator £m	31 March 2013 Actual £m
Opening balance	76.47	53.65	53.65
Add unfinanced capital expenditure (as above)	8.21	3.60	2.96
Less HRA Debt Settlement	(30.48)		
Less MRP	(0.55)	(0.7)	(0.71)
Closing balance	53.65	56.55	55.90

3.5 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2012/13. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2012 Actual £m	31 March 2013 Original £m	31 March 2013 Actual £m
Net borrowing position	32.20	39.97	33.54
CFR	53.65	56.55	55.90

The authorized limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2012/13 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2012/13
Authorized limit	£71.6m
Maximum gross borrowing position	£40.7m
Operational boundary	£56.6m
Average gross borrowing position	£34.7m
Financing costs as a proportion of net revenue stream: Non HRA HRA	 4.18% 9.83%

4.0 Treasury Position as at 31 March 2013

4.1 The Council's debt and investment position is organised by staff within Financial Services in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2012/13 the Council's treasury position was as follows:

TABLE 1	31 March 2012 Principal	Rate/Return	31 March 2013 Principal	Rate/Return
Fixed rate funding:				
-PWLB	£18.71m		£28.71m	
-Market	£15.50m		£10.50m	
- Serco Paisa	£1.69m		£1.49m	
Total debt	**£35.90m**	**5.49%**	**£40.70m**	**5.11%**
CFR	£53.65m		£55.90m	
Over/ (under) borrowing	(£17.75)		(£15.20m)	
Total investments	**£3.7m**	**0.88%**	**£6.7m**	**1.35%**

All investments were for under one year.

4.2 The maturity structure of the debt portfolio excluding Serco Paisa was as follows:

	31 March 2012 Actual £m	2012/13 Original limits £m	31 March 2013 Actual £m
Under 12 months	8.00	9.80	4.52
12 months and within 24 months	1.52	19.60	4.64
24 months and within 5 years	4.64	29.41	7.00
5 years and within 10 years	9.02	39.21	12.02
10 years and above	11.03	39.21	11.03

The exposure to fixed and variable rates was as follows:

	31 March 2012 Actual £m	2012/13 Original Limits £m	31 March 2013 Actual £m
Principal - Debt Fixed rate	35.91	£56.60	40.70
Principal – Investments Variable rate	(3.70)	N/a	(6.70)

5.0 The Strategy for 2012/13

5.1 The expectation for interest rates within the strategy for 2012/13 anticipated low Bank Rate until quarter 4 of 2013. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk. Longer term borrowing was expected to be taken during the year to lock into lower rates and protect the Council from future rises.

The actual movement in interest rates broadly followed the expectations in the strategy, however rates have continued to remain low and are not expected to rise until quarter 1 of 2015.
During 2012/13 the Council used internal balances and temporary borrowing at historically low interest rates to ensure new borrowing was taken at the most advantageous rates. New borrowing of £4m was taken in May 2012 and a further £6m in March 2013.

6.0 Borrowing Outturn for 2012/13

6.1 **Treasury Borrowing**.

Borrowing – two new loans totalling £4m were drawn down in May 2012 to replace maturing temporary debt (£3m) and fund the net unfinanced capital expenditure. A further two loans totaling £6m were drawn down in March 2013, locking in to historically low rates. The loans drawn were all fixed rate as follows:

Lender	Principal	Interest Rate	Maturity
PWLB	£2m	1.96%	24/3/17
PWLB	£2m	1.87%	24/3/17
PWLB	£3m	1.48%	24/9/17
PWLB	£3m	2.66%	22/9/22

This compares with a budget assumption of borrowing at an interest rate of 3.25%.

Rescheduling – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.

Repayment – £3m of temporary debt was repaid on maturity during the year.

Summary of debt transactions – the overall position of the debt activity resulted in a fall in the average interest rate by 0.38%, representing a saving to the General Fund.

7.0 Interest Rates in 2012/13

7.1 The tight monetary conditions following the 2008 financial crisis continued through 2012/13 with little material movement in the shorter term deposit rates.

7.2 Bank Rate remained at its historical low of 0.5% throughout the year. Investment rates dropped and continued to be very low. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns was limited. The investment rates at the beginning and end of the year are provided below.

Investment Term	Interest Rate March 2013	Interest rate April 2012
Overnight	0.40%	0.50%
1 Month	0.40%	0.73%
3 Months	0.45%	1.05%
6 Months	0.55%	1.35%
9 Months	0.70%	1.60%
12 Months	0.80%	1.85%

The PWLB rates at the beginning and end of the year are provided below.

Loan Term	Interest Rate March 2013	Interest rate April 2012
1 Year	1.13%	1.28%
5 Years	1.75%	2.05%
10 Years	2.84%	3.21%
20 Years	4.07%	4.17%
50 Years	4.22%	4.36%

8.0 Investment Outturn for 2012/13

8.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 8 February 2012. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 **Resources** – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2012 £m	31 March 2013 £m
Balances	4.66	3.92
Earmarked reserves	3.85	3.44
HRA	2.00	2.18
Major Repairs Reserve	1.08	2.67
Capital Grants & Contributions	5.02	5.00
Usable capital receipts	2.25	3.45
Total	**18.86**	**20.66**

8.4 **Investments held by the Council** - the Council maintained an average balance of £8.98m of internally managed funds. The internally managed funds earned an average rate of return of 1.35%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.39%.

9.0 The Economy and Interest Rates Forecast

9.1 Economic background:

- Indicators suggested that the economy accelerated;
- Stronger household spending, both on and off the high street;
- Inflation remained above the MPC's 2% target;
- The MPC remained in a state of limbo ahead of Mark Carney's arrival;
- 10-year gilt yields rose above 2.5% and the FTSE 100 fell below 6,100;
- The Federal Reserve discussed tapering the pace of asset purchases under Quantitative Easing 3.

9.2 The Council's treasury advisor, Sector, provides the following forecast:

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB rate	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%
10yr PWLB rate	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%
25yr PWLB rate	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%
50yr PWLB rate	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%

The Sector central forecast is for the first increase in Bank Rate to be in the March 2015. However, forecasts for PWLB rates have been increased as a result of the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East. .

9.3 **Summary Outlook**

In Mervyn King's last Inflation Report as Governor of the Bank of England, there was a distinct shift towards optimism in terms of a marginal upgrading of growth forecasts so that the wording changed for the recovery from "remain weak by historical standards" to "modest and sustained recovery over the next three years". In addition, there was a lowering of the inflation forecast to now hit the 2% target within two years. However, this is still a long way away from strong recovery though the chances of there being more quantitative easing (QE) have receded due to business surveys indicating that the economy is on the up. QE has not increased from a total of £375bn since October 2012 and other measures have been implemented in preference to further QE. Thus the Funding for Lending Scheme (FLS), (started in August 2012), was expanded in April to provide further incentive to banks to expand lending to small and medium size enterprises. The FLS certainly seems to be having a positive effect in terms of stimulating house purchases (though levels are still far below the pre crisis level), and a marginal increase in house prices. However, concerns are increasing that QE and FLS are also in danger of causing asset price bubbles. Investors may seek higher returns by switching investment of cash from deposit accounts (yielding very low rates) and from government and corporate bonds - ahead of the eventual end of QE - to equities, whilst FLS may have the side effect of inflating house prices, creating the potential for prices in each of these markets to be pushed at some point in time to potentially unsustainable levels.

10.0 **Executive Summary and Conclusion**

10.1 During 2012/13, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2011/12 Actual £m	2012/13 Original £m	2012/13 Actual £m
Actual capital expenditure	14.66	14.54	12.28
Total Capital Financing Requirement: • Non-HRA • HRA • Total	 16.91 36.74 53.65	 19.81 36.74 56.55	 19.16 36.74 55.90
Net borrowing	32.20	39.46	34.00
External debt	35.90		40.70
Investments (all under 1 year)	3.70		6.70

Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

The financial year 2012/13 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

11.0 Consultation

Not applicable